



Milkpak Limited—International Joint Venture

On January 25, 1987, Syed Babar Ali, chairman, and Syed Yawar Ali,¹ managing director of Milkpak Limited, prepared for a meeting with a high-level team from Nestle, a multinational food company based in Switzerland. Milkpak Limited, incorporated in 1979, was a pioneer in developing a Pakistani industry for ultra-high temperature (UHT) milk, a sterilized milk that did not require refrigeration when specially packaged. The increasing popularity of UHT milk caused company sales to increase from 96 million rupees in 1982—Milkpak's first full year of production—to 340 million rupees in 1986. The company was increasingly interested in producing value-added products and was exploring a joint venture with a foreign company.²

Company Background

Milkpak was part of a family group of businesses—the Ali Group—that spanned a number of interests. Considered one of Pakistan's leading industrial families, the Ali Group was involved in razor blade and textile manufacture in addition to having holdings in the insurance industry. The group had major investments in the vegetable oil and soap industries and also managed Ford's auto assembly plant prior to 1973, when the government nationalized all of these businesses.

Milkpak was founded to create a market for packaging materials produced by Packages Limited, a leading company in the Ali Group. Packages Limited was established in Lahore, Pakistan, in 1956, in collaboration with AB Akerlund & Rausing of Sweden, to convert paper and board into packaging. Packages later integrated backwards into pulp and paper manufacturing. The company supplied packaging materials to a variety of industries and also provided technical assistance to packaging plants in Africa and the Middle East. Packages manufactured its own line of facial tissues and other consumer products. In 1986, Packages' total sales were approximately Rs. 633 million.

Milkpak was established following a 1976 review of the use of Packages' equipment. The Tetra Laminator, a machine designed for making packaging material for long-life milk, was used very infrequently. Packages purchased the Tetra Laminator machine in 1967 from Tetra Pak of

¹ Yawar Ali was Babar Ali's nephew.

² Exchange rate in 1986: Rs. 16.65 = \$1.00.

Research Associate Afroze A. Mohammed prepared this case under the supervision of Professor John A. Quelch as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. This case contains some information from earlier cases on Milkpak prepared by the Lahore University of Management Sciences.

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Sweden, a company affiliated with Akerlund & Rausing. The Tetra Pak aseptic system³ was developed to package UHT milk. The UHT process heated milk at temperatures of 130–150 degrees centigrade for 2–3 seconds. Milk thus sterilized had a shelf life of up to three months without refrigeration when packaged in Tetra Pak containers. The Tetra Pak system had special advantages for developing countries that lacked extensive refrigeration and distribution systems. Some of the packages were in the shape of tetrahedrons (a four-faced pyramid); rectangular packages that required heavier and more expensive paper were also available.

Packages found that there was one milk plant in Pakistan, at the time inoperative, designed to produce sterilized milk. The company leased the plant, with a capacity of 17,500 liters of milk per day, as a pilot project to test the market for UHT milk. Packages hoped that a successful pilot project would encourage entrepreneurs to produce UHT milk, thereby increasing the demand for Tetra Pak packaging. To implement the project, a number of challenges were surmounted, including developing a low-cost, locally produced paper for packaging and securing reliable sources of milk supply. The pilot project was deemed a success in 1978 when, with limited promotional efforts, sales reached plant capacity.

Milkpak was incorporated in January 1979 after Packages decided to invest in a 150,000 liters/day UHT milk plant, at a cost of Rs. 90 million. Financing for the new company was obtained from Tetra Pak; Danish Turnkey Dairies, the equipment supplier; and several development agencies, including the International Finance Corporation and the German Development Institute. (**Exhibit 1** summarizes Milkpak's ownership structure.)

Milkpak started commercial production of UHT milk in its new plant in November 1981. (**Exhibit 2** provides Milkpak's yearly sales and profit and loss statements from 1981 to 1986.) By 1987, Milkpak's product line had expanded from UHT milk to include fruit juices and other dairy products, though UHT milk still accounted for an estimated 85% of company sales. In 1984, Milkpak started marketing the Frost line of fruit juices, introduced a few years earlier by Packages. Frost juices were premixed, in contrast to existing juices on the market that were available in concentrate form. Milkpak bought the Frost brand name and equipment from Packages, and in 1986 fruit juices accounted for 9% of Milkpak's sales. Additional products included butter, introduced in 1985. In 1986, the company launched a sterilized cream product, "balai," and also a cooking oil, "Desi Ghee." These products were sold under the brand name Milkpak.

Pakistan

Pakistan was founded in 1947, when British India was partitioned into two nation states. Pakistan, established as a Muslim country, initially had two geographically separate sections on either side of India. In 1971, the eastern wing of Pakistan separated to form Bangladesh. The western section, which remained Pakistan, had Urdu as its national language, with English widely spoken. By 1986, Pakistan had a population of over 90 million. Pakistan's GNP per capita was \$380, although the country had large income disparities. (**Exhibit 3** provides basic social and economic data about Pakistan.)⁴

In the 1980s, Pakistan had political and economic policies that promoted the role of private enterprise in the country's economy. This climate was in contrast to that prevailing from 1972 to 1977 when the government was concerned about the high concentration of industrial ownership and

³ An aseptic system is free from pathogenic organisms.

⁴ Background information in this section is from *Pakistan and the World Bank: Partners in Progress* (Washington, D.C.: The World Bank, 1986).

nationalized a number of businesses. In the mid-1980s, the rate of growth of manufacturing output was 9.1% per year, while agricultural output grew at 4.6% per year; from 1972 to 1977, these sectors had grown each year at only 5.2% and 2%, respectively.⁵ Policy initiatives made in the 1980s offered safeguards against nationalization and sought to ensure the safety of investments.

While the overall climate for private investment was favorable, businesses had to obtain a variety of government licenses and approvals before undertaking or expanding projects. These approvals differed according to a project's source of funds and specific characteristics. The government's permission for a project would address issues such as the amount of investment allowed, procedures governing repatriation of capital and profits, the amount of raw materials that could be imported, and the location of the industrial establishment. In practice, obtaining these approvals could result in project delays, although the Pakistani government was making efforts to facilitate the process.

The Pakistani Dairy Industry

Fresh milk was traditionally supplied to urban consumers directly from farms on a daily basis.⁶ Consumers obtained milk (1) directly from farmers or dairy colonies (these sources were sometimes referred to as peri-urban producers) that kept buffalos in or near the towns, and (2) from milkmen who purchased milk from farmers. Milkmen would travel the countryside by bicycle, collect milk in 40-liter cans, and then sell it to contractors, who put ice in the milk and then transported it into the city. The milk was then sold to consumers at their homes and through retail milk shops, which did not have refrigeration facilities. The entire process, from milking the buffalos to selling the milk in the city, took place each morning. While the system delivered fresh milk to consumers each day, it had drawbacks. In particular, adulteration of milk with impure water occurred at various stages in the distribution chain. In addition, the absence of a refrigerated distribution infrastructure led to milk spoilage and waste.

The problems of transporting and distributing milk resulted in shortages in major urban centers—Milkpak's target market. Shortages were exacerbated by the marked seasonality in production and consumption of milk. Milk consumption peaked during the summer. In contrast, milk production was highest during the winter months of December-March, called the "flush" season, and lowest during the "lean" season from May to August. Lower production during the summer was caused by hot weather and decreased availability of fodder. As a result of both of these factors, the Pakistani government adopted liberal policies towards the import of milk products. (Exhibit 4 provides data on Pakistani milk production and dairy imports.)

Milk powder was a particularly important dairy import. Milk powder, mixed with water to make fluid milk, had an established place in the Pakistani market, especially in Karachi, where fresh milk supplies were insufficient to meet demand as a result of increases in population. In 1986, about 30% of the demand for fluid milk supplies in Karachi was met by milk powder. Demand for milk powder was met primarily by imports, which averaged 20,000–30,000 tons annually. Powder was imported both as a branded product, in tins, and also in bulk (25 kilogram bags). Bulk supplies were repackaged by retailers in 1½ kg⁷ plastic bags. Branded milk powders were typically bought by

⁵ Shahid Javed Burki, *Pakistan: A Nation in the Making* (Boulder: Westview Press, 1986), p. 115.

⁶ Background information in this case about the Pakistani dairy industry, including the UHT industry, is from *Pakistan's Dairy Industry: Issues and Policy Alternatives* (Islamabad: The Directorate of Agricultural Policy and Chemonics International Consulting Division, 1989).

⁷ There are 1,000 kilograms in a metric ton.

higher-income consumers while the repackaged bulk supplies were purchased by lower- and middle-income consumers.

Efforts had also been made to establish an indigenous local milk processing industry. Packages' decision to invest in Milkpak was made in spite of a history of failed investments in the milk processing industry. During the 1960s and 1970s, Pakistani entrepreneurs established 23 plants in the dairy processing field, including several plants for milk pasteurization. The failure of at least 15 of this "first generation" of dairy processing plants was attributed to poor management, difficulties in obtaining fresh milk supplies, and the lack of an extensive refrigerated distribution infrastructure.

Milk Collection

To ensure a reliable and high-quality supply of milk, especially during the lean season, Milkpak focused attention on developing a system for milk collection and agricultural extension. Milk collection centers were established in areas considered rich in milk production. The company taught farmers scientific techniques of livestock care and breeding, provided veterinary services, and made available high-yielding fodder seed and cattle feed. Milk was supplied to the company by traditional milk contractors who bought milk from farmers. In addition, Milkpak helped establish village cooperatives and, through them, received milk directly from farmers.

During the flush season, Milkpak often had to refuse milk supplies. Milkpak's management visited dairies in India, including Nestle's plant, to gain an understanding of how other dairies in a similar environment addressed problems of seasonality.

UHT Milk Processing

Processed milk was required by law to contain 3.5% butterfat and 8.9% solids not fat (SNF). Fresh milk usually had a higher fat content and a lower level of solids than required. As a result, before being heated to 130–150 degrees centigrade, the milk was decreamed to reduce the fat content. To raise the SNF level, skimmed milk powder and water were added. When there was a shortage of fresh milk, milk powder could be added to increase milk production volumes, although, at prevailing prices for imported milk powder, it was rarely economical to do so. The technology for manufacturing UHT milk was considered expensive, with processing costs accounting for about 25% of total product costs. (Exhibit 5 reports estimates of UHT processing costs, obtained from different manufacturers in the industry.) Packaging materials, which were heavily taxed, accounted for another 26% of Milkpak's production cost.⁸

UHT Milk Marketing

Positioning. A major challenge facing the company was to introduce urban consumers to the idea of long-life milk. Consumers were concerned that sterilized milk contained preservatives or was somehow not genuine because, unlike fresh milk, the Milkpak brand contained no cream. In one early promotional campaign, households were given two samples of Milkpak, one for immediate consumption and the other to be consumed four days later; the goal was to demonstrate that while the milk remained packaged it did not require refrigeration. Milkpak was positioned as a pure dairy product, processed in a scientific, hygienic way, and consistent in quality throughout the year. (Exhibit 6 and Exhibit 7 show print advertisements for Milkpak brand UHT milk and butter. Sales promotion and advertising expenses for Milkpak are summarized in Exhibit 8.)

⁸ *Pakistan's Dairy Industry*, p. 16.

Milkpak's heavy users were "modern housewives," who were concerned about both convenience and product quality. Another target market was lower-income consumers, who were often sold relatively cheap adulterated milk by the traditional milkmen; Milkpak provided a higher-quality milk than they had purchased before. (Exhibit 9 presents the results of a consumer survey sponsored by Milkpak.)

Packaging. Milkpak brand UHT milk was initially sold in tetrahedron shaped containers, in sizes of $1/2$ liter and $1/5$ liter. In 1984, a one-liter rectangular-shaped "brickpak" was introduced. The more conventionally shaped brickpak eliminated the need for special crates required to store tetra paks, but used more packaging material. In 1986, a quarter-liter brickpak was introduced.

Pricing. Table A shows the 1986 retail prices for Milkpak and other types of milk in two major cities in Pakistan. Milkpak competed with the traditional milk distribution system that supplied fresh, or "raw," milk to consumers each day. Milk powder competed with Milkpak as a convenience product.

Table A Comparative Retail Prices of UHT Milk, Raw Milk, and Dried Milk Powder in Different Cities in Pakistan (rupees per liter)

City	Raw Milk		Whole Milk Powder ^b		UHT Milk
	Peri-Urban Producer	Milk Shop ^a	Tinned	Polythene Bags	
Lahore	5.00–6.00	4.50–5.50	7.50	6.00	7.50
Karachi	5.50–7.00	5.00–6.50	6.88	5.50	8.00

Source: Adapted from Table 2.5 in *Pakistan's Dairy Industry: Issues and Policy Alternatives* (1986).

^aIn general, the quality of milk sold by milk shops was poorer than that sold by peri-urban producers.

^bIn liquid milk equivalent terms, assuming a dried milk to liquid conversion ratio of 1:8.

Distribution A key success factor in Milkpak's rapid growth was the expansion of its distribution network. In 1981, there were an estimated 1,000 retail outlets selling Milkpak; by 1986, the number had grown to 13,000. Milkpak was sold in grocery stores, bakeries, general stores, and supermarkets. The company had sales offices in Karachi, Lahore, and Islamabad, and had a nationwide network of distributors in all the major cities and towns. For Milkpak brand milk, the margin to the distributor was between .2 and .25 rupees per liter, depending on the shipping distance. The retail margin was .52 rupees per liter. The UHT business was viewed as similar to the soft drink business, with high turnover and low margins, requiring flexibility and fast decision making.

Evolution of the UHT Milk Industry

Milkpak's success in developing a market for UHT milk spurred the entry of several other companies. By the end of 1986, eight plants owned by different companies could manufacture UHT milk. Total sales of UHT milk grew from 11.25 million liters in 1981 to approximately 80 million in 1986.⁹ In 1986, Milkpak estimated that its share of the market was over 50%. Milkpak had a reputation for consistent, high quality, both with consumers and the trade.

Some of Milkpak's early competitors were short-lived. Milkpure and Purabrand, which entered the market in 1983, competed with Milkpak by offering consumer and trade promotions such as free tea bags and raffles for free air tickets. Milkpak did not offer similar promotions in response; management felt that profit margins on UHT milk did not allow such marketing investments. Both companies had financial problems and went out of business by the end of 1985.

⁹ *Pakistan's Dairy Industry*, p. 12.

Other more stable competitors included Milko, the UHT plant originally leased by Packages to test the market for UHT milk. Milko returned to its original owners after Milkpak's founding. By 1986, Milko had an estimated 10% share of the market. Pakistan Dairies, the country's first producer of cheese, started manufacturing UHT milk in 1983. Because of its other dairy products, Pakistan Dairies had an extensive and effective system for milk collection and was regarded as a high-quality producer. In 1986, the company's share of the market was approximately 18%–20%. A new competitor, Chaudhuri Dairies, entered the market in June 1986 and captured a share of 15% by year end. Chaudhuri introduced its brand Haleeb in rectangular brickpak packaging, which was more convenient to store and was considered a competitive advantage.

While the sales of UHT milk grew rapidly, they still constituted a relatively small share of total consumption. It was estimated that by 1987, UHT accounted for approximately 2% of the milk consumed in Pakistan's urban areas.

The emergence of an industry to process UHT milk was fostered by government policy, notably duty exemptions on the import of machinery for dairy plants and the provision of low cost financing by government agencies. The government had sanctioned a number of additional plants that would be brought on line in coming years, and there was, therefore, concern that the industry would have substantial overcapacity.¹⁰

Strategic Options for Growth

As Milkpak reviewed its growth options, management increasingly saw the development of a milk powder plant as a necessity. First, a powder plant would help smooth the seasonal mismatch between the supply of and demand for milk. During the summer (the time of peak demand), milk powder would be combined with liquid milk to extend the supplies of UHT milk. The growth potential for UHT milk had been limited by seasonality; Milkpak's marketing managers were reluctant to promote UHT milk heavily during the flush season because they felt they were creating demand that could not be satisfied in the lean season. While Milkpak's managers were very committed to increasing UHT milk sales, they knew that the UHT business was inherently a high volume, low margin business. As a result, the company wanted to explore the possibility of producing other value-added foods, such as milk powder, cereal, and infant formula, among other products.

In addition to using milk powder as an ingredient in UHT milk, Milkpak could sell milk powder, which competed with UHT milk, as a convenience product. In 1986, 25,002 tons of milk powder, with a value of Rs. 406 million, were imported. Only two domestic companies manufactured milk powder, one of which produced solely for the military. The other company, Noon Ltd., established with the technical assistance of Cow & Gate, a U.K. company, had an output of 600 tons/year. The Pakistan Dairy Association, chaired by Yawar Ali, argued that the government's low tariffs on milk powder imports (which historically had been subsidized by European producers) impeded the development of a domestic dairy industry. In 1986, the government imposed a 16% tax on imports of milk powder, which improved the viability of domestic production.

About 20% of milk powder imports were branded. The major brands, with estimated market shares, were NIDO, produced by Nestle (24% market share); Red Cow, manufactured by Cow & Gate (25% of market); and Safety, manufactured by Friesland—of the Netherlands—(24% market share.) NIDO's prices were the highest (Rs. 107 per 1800 gram tin), followed by Red Cow (Rs. 92–102/tin)

¹⁰ *Pakistan's Dairy Industry*, p. 19.

and Safety (Rs. 93–97/tin.) The demand for branded milk powder was forecast to increase to 18,000 tons/year by 1996.

Milkpak's management had to decide whether to acquire foreign technology and management assistance to develop its own plant. Alternatively, Milkpak considered the possibility of finding a foreign joint venture partner.

Independent Study

Milkpak prepared a feasibility study for a milk powder plant. **Exhibit 10** provides a summary of the project costs, financing sources, and projected profits. Milkpak estimated that by the third year of operation the plant would produce 2,400 tons of milk powder. A locally manufactured product could be competitively priced relative to imports. In addition, a Milkpak plant would use buffalo milk, a familiar taste for local consumers. A study of the milk powder market commissioned by Milkpak recommended that Milkpak produce a branded product to capitalize on Milkpak's name and reputation. In addition to producing milk powder, the plant would also manufacture infant formula, butter oil, and butter.

Milkpak expected to hire an experienced expatriate production manager. While Milkpak executives thought it was feasible for the company to develop a powder plant without a joint venture partner, they were concerned about the technical difficulties of doing so. For example, they felt that producing products such as infant formula required technical knowledge and expertise that the company did not have.

Joint Venture Partners

A joint venture partner could provide both the necessary technology and a reputable brand name that could be attached to locally manufactured, value-added products. Milkpak's managers debated the advantages and drawbacks of conducting a joint venture. Some thought Milkpak should seek out a joint venture partner that currently exported branded products to Pakistan and already had some brand recognition in Pakistan. Others were concerned that a company with established brands would expect high royalties that would leave too little profit for Milkpak to warrant the investment risk.

Another concern was that a large multinational joint venture partner might dominate Milkpak. Chairman Babar Ali, however, felt very comfortable with the prospect of a joint venture; Packages Limited, where he had worked for much of his career, was itself a joint venture.

A major challenge was to identify appropriate joint venture partners and find ways to approach them. Danish Turnkey Dairies and Tetra Pak, companies Milkpak and Packages already had ties with, could help in identifying and providing introductions to potential joint venture partners. As a result, Friesland and Nestle emerged as particularly interesting prospects for a joint venture partnership.

Friesland Friesland, established in 1913 as the "Cooperative Condensed Milkfactory Friesland," was founded by farmers in the Friesland province of Holland. Over 12,000 Dutch farmers supplied milk for the production of a variety of dairy products, including condensed and powdered milk and infant foods. In 1986, Friesland's net sales were 1,807 million guilders.¹¹

¹¹ Exchange rate in 1986: 2.45 Guilders = \$1.00.

Friesland's products were sold in 130 countries, primarily through exports. Friesland exported Safety brand milk powder and Omela brand condensed milk to Pakistan. The company also operated some manufacturing facilities and dairies overseas, usually in partnership with a local company. These included manufacturing plants in Guam, Indonesia, Lebanon, Malaysia, Nigeria, Taiwan, Thailand, Saudi Arabia, and Yemen. Friesland provided technical assistance to its affiliated companies as well as management assistance on a contract basis.

Nestle S.A. Nestle was founded in 1867 by Henri Nestle, a chemist who developed the first milk-based food for babies. In 1905, the company merged with the Anglo-Swiss Condensed Milk Company, a former competitor. From a base in dairy products, Nestle's product line grew to encompass chocolate and confectionery, instant and roasted coffee, culinary products, frozen foods, and instant drinks. By 1986, Nestle's consolidated sales were 38,050 million francs.¹²

Early in its development, Nestle established production facilities outside of Switzerland. By 1986, Nestle had plants in 60 countries. In determining whether to set up production facilities in a particular country, the company considered several factors, including the availability of raw materials, the overall economic climate, and consumer tastes and purchasing power. Nestle's approach to foreign operations was summarized as follows: "The Company is guided in this respect by long-term goals and not by short-term objectives. It is essential for Nestle that an industrial operation be in the reciprocal and lasting interests of both the Company and the host country."¹³

A hallmark of Nestle was decentralization, which enabled the group's overseas subsidiaries to develop their own identity and the flexibility to respond to local market conditions. At the same time, Nestle provided research, development, and technical assistance to these subsidiaries. This assistance could be used, for example, to develop products suited to local tastes and to improve the productivity of land and livestock.

Nestle in Pakistan Since 1974, Nestle products had been imported and sold by the Burque Corporation, a small Pakistani distributor. In 1975, Burque decided to introduce Nestle's NIDO brand of powdered milk, which accounted for an increasing share of Nestle sales in Pakistan. Nestle products were supported by an intensive distribution network and were also heavily advertised on television.

In 1983, Nestle stationed a marketing advisor, Erwin Wermelinger, in Pakistan. Wermelinger's role was to investigate investment opportunities in addition to providing assistance to Nestle's distributor. During the mid-1980s, Nestle staff conducted a tour of the Punjab region of Pakistan to assess the potential for collecting milk to be used in local production of Nestle products.

Joint Venture Negotiations

Discussions with Nestle

Milkpak's management was aware of Nestle's growing interest in the Pakistani market, as indicated by Wermelinger's presence in Pakistan. One of Milkpak's managers, formerly with Packages, knew Wermelinger from an earlier posting in Tanzania. As a result, there was an informal channel of communication between the two companies, which Milkpak viewed as a means of keeping Nestle apprised of Milkpak's progress.

¹² Exchange rate in 1986: 1.80 Swiss Francs = \$1.00.

¹³ Nestle, S.A., *Nestle, The Story of an International Company* (Vevey: Nestle, S.A., 1991), p. 10.

Milkpak approached Nestle's senior management in 1986, when Babar Ali visited Nestle's headquarters in Switzerland. During these conversations, Ali received the impression that Nestle would want majority ownership in a joint venture and might also require sizable royalties and technical fees. In addition, Ali was concerned that Nestle's attitude toward Milkpak seemed overbearing.

Discussions with Friesland

Milkpak first approached Friesland in November 1985, through a mutual contact. Several factors made Friesland an attractive candidate for a joint venture, including extensive experience in the dairy industry and an established position in the Pakistani milk powder market. Milkpak's management also felt that a company of Friesland's size would be more responsive to Milkpak's concerns than a larger multinational.

An initial meeting between Babar Ali and a Friesland marketing director was followed by the visit of a three-member Friesland team to Pakistan in March 1986. The team included representatives from the marketing, finance, and technical areas. They spent two weeks studying both Milkpak and the Pakistani market. After the team's visit, Friesland made several requests for additional information. Company representatives next met in October 1986, when both Babar Ali and Yawar Ali visited the Friesland headquarters in Holland to meet the company's chairman and directors and tour the corporate plant and R&D facilities. Milkpak's executives were not shown the milk powder factory.

Friesland planned to follow the October meeting by sending a team to prepare a detailed feasibility study that would consider the milk powder project and other possible product introductions, such as cheese and ice cream. Friesland's tentative plans were to buy 25% of Milkpak's shares, obtain technical fees and royalties for their brands, and increase equity to 49% over a five-year period. Friesland targeted the end of March 1987 as the date for making a final decision about the proposed joint venture.

A number of issues remained to be resolved. Milkpak needed to determine what government policies were with respect to technical fees and royalties on consumer products, assuming that Friesland made an initial equity investment of 25%. Friesland wanted to obtain royalties on its products in the range of 3%–5%. In addition, for Friesland to be able to increase share holdings beyond 25%, changes in the ownership structure of Milkpak could be required, such as the divestment of some of the existing foreign shareholders.

While Friesland was an attractive candidate for a joint venture, Milkpak had some reservations. Milkpak's executives were concerned that Friesland had not let them tour Friesland's milk powder factory on two separate occasions, which suggested that Friesland might be withholding certain information. Milkpak attributed Friesland's many requests to Milkpak for information to Friesland's relatively limited experience in establishing production facilities overseas. The time period within which Friesland expected to obtain a return on its investment was uncertain. Some managers at Milkpak also felt that, in light of Friesland's history as a dairy cooperative, the company would always be more interested in finding markets for products produced in Holland than in developing the Pakistani dairy industry.

Rudolf Tschan's Visit

In January 1987, Babar Ali was apprised of the forthcoming visit of Rudolf Tschan, Nestle's new executive vice president for Asia Zone II, to Pakistan. According to Erwin Wermelinger, Nestle's marketing representative in Pakistan, Tschan wanted to come to Lahore to meet Ali, tour Milkpak's Sheikhpura factory, and visit the company's milk collection centers.

On January 25, Yawar Ali led Rudolf Tschan and the Nestle team on a tour of Milkpak's plant and milk collection areas. Ali was struck by Tschan's quick assessment of the surroundings: "This side looks a lot like the other side [Indian Punjab], but your buffalo are better and your land is more fertile." As Tschan toured the milk plant, he noted that "we will have one milk powder plant here and one there [India]."

When Yawar Ali briefed Babar Ali about the Nestle team's tour, he noted Tschan's evident interest in the Milkpak operation. Later in the day, top executives from Milkpak and Packages were scheduled to meet with Tschan and Wermelinger to discuss the prospect of Nestle and Milkpak working together. As Milkpak's team prepared for the meeting with Nestle, they considered the major issues that would arise. In addition, they considered the benefits to each company of working together.

Assessing a Nestle Joint Venture

For Milkpak, the possibility of a joint venture with Nestle was appealing. The fact that Nestle had a successful manufacturing operation, including a milk powder plant 80 miles across the border in Moga, India, gave Milkpak confidence that Nestle knew how to operate in a very similar environment. Milkpak's management also believed that Nestle typically took a long-term approach toward developing its operating companies. In addition, Milkpak might benefit from Nestle training for its staff and from increased sales by other companies in the Ali Group. For example, Nestle products could use packaging made by the group's companies.

At the same time, management felt that Milkpak offered a number of advantages as a joint venture partner. Milkpak knew that its extensive milk collection infrastructure provided access to a key raw material for Nestle products. Milkpak's government contacts would facilitate obtaining the requisite licenses for establishing new production facilities. The Ali Group had a successful history of implementing other joint ventures. Through a joint venture with Milkpak, Nestle would eliminate a potential future competitor that knew the Pakistani market. The fact that Tschan had come to Pakistan to see Milkpak's operations indicated that Nestle already had a favorable impression of the company's capabilities.

Retaining majority ownership was important to Milkpak's management because Milkpak executives wanted to ensure that any joint venture partner paid attention to their ideas about the business. Babar Ali's earlier meeting with Nestle management suggested that coming to mutually agreeable terms on topics such as majority ownership could present a challenge. However, Tschan seemed to be more flexible.

In addition to the question of ownership, both companies were likely to be concerned about management control of the operation. For example, Nestle might want to appoint the milk powder plant manager. In addition, Nestle already had an effective existing system for distributing its products in Pakistan, which would need to be integrated with Milkpak's marketing system.

Another agenda item concerned the products to be produced and sold by the joint venture and the location of their manufacture. Some Nestle products currently imported could be manufactured locally in the new plant; others would continue to be imported. The new plant might also permit local manufacture of other Nestle products not currently exported to Pakistan. Finally, there existed the possibility of introducing new products tailored more precisely to the consumption preferences of Pakistani consumers.

Conclusion

As Milkpak's management approached the meeting with Rudolf Tschan, they contemplated the key issues that would be addressed. Milkpak's objective was to increase its penetration of and success in the Pakistani market. The company was already involved in an extended negotiation with Friesland, a fact they would tell Nestle, and one that gave Milkpak some additional leverage. At the same time, they needed to carefully evaluate what terms would make a joint venture with Nestle more appealing than one with Friesland. The Milkpak executives had to decide what negotiating positions to adopt. Milkpak's executives were aware that, should they conduct a joint venture with Nestle, today's meeting would set the foundation for a relationship that was likely to change and evolve over time.

Exhibit 1 Ownership Shares of Milkpak

Investor	Ownership Share
Ali family	15.7%
Packages Limited	7.1
IGI ^a	5.7
International Finance Corporation	5.7
Tetra Pak ^b	8.6
DEG ^c	5.7
DTD ^d	2.9
IFU ^e	2.9
Public shareholders	45.7%

Source: Company records.

^aInternational General Insurance Company, 99% owned by the Ali family.

^bThe Swedish manufacturer of the equipment used to make materials for the nonrefrigerated milk containers.

^cThe German Development Institute, a foreign aid and development institution.

^dDanish Turnkey Dairies, Limited, Milkpak's equipment supplier and the provider of Milkpak's specialized extension services to Pakistani dairy farmers.

^eIndustrial Fund for Developing Countries, Denmark.

Exhibit 2 Milkpak Profit-and-Loss Statements: 1981–1986

	1986	1985	1984	1983	1982	1981 (2 months)
Net sales	340,343,535	251,835,221	214,662,630	137,310,716	96,129,181	9,409,358
Cost of goods sold	<u>296,417,357</u>	<u>223,485,654</u>	<u>185,175,145</u>	<u>114,742,655</u>	<u>85,894,230</u>	<u>9,986,726</u>
Trading profit	43,926,178	28,349,567	29,487,485	22,568,061	10,234,951	(577,368)
Selling, administrative, and general expenses	<u>30,294,796</u>	<u>17,980,055</u>	<u>14,959,910</u>	<u>10,723,215</u>	<u>8,731,245</u>	<u>1,413,890</u>
Operating profit/(loss) ^a	13,631,382	10,369,512	14,527,575	11,844,846	1,503,706	(1,991,258)
Other income	<u>1,043,295</u>	<u>970,458</u>	<u>773,190</u>	<u>342,738</u>	<u>342,021</u>	<u>1,194,391</u>
	14,674,677	11,339,970	15,300,765	12,187,584	1,845,727	(796,867)
Financial charges	7,495,788	5,258,607	5,828,054	5,713,972	6,868,285	900,448
Workers' participation fund	361,500	355,970	546,389	414,430	--	
	<u>7,857,288</u>	<u>5,614,577</u>	<u>6,374,443</u>	<u>6,128,402</u>	<u>6,868,285</u>	<u>900,448</u>
Profit before taxation	6,817,389	5,725,393	8,926,322	6,059,182	(5,022,558)	(1,697,315)
Provision for taxation	<u>3,045,000</u>	<u>1,603,000</u>	<u>4,535,000</u>	--	--	--
	3,772,389	4,122,393	4,391,322	6,059,182	(5,022,558)	(1,697,315)

Source: Company records.

^aThe decline in operating profit as a percentage of net sales in 1985 and 1986 was primarily due to switching to an aluminum foil packaging paper that improved the shelf life of Milkpak brand milk, starting a new fruit juice plant, and increases in sales promotion expenses.

Exhibit 3 Pakistan: Basic Country Data

Area:	803,940 sq. km.
Agricultural land (1983):	254,900 sq. km.
GNP per capita (1984):	\$380
Energy consumption per capita (1983):	179 kg. of oil equivalent
Population (1984):	93.3 million
Urban population (percentage of total):	30.1
Projected population in 2000:	143 million
Population density (1984):	116.0 per sq. km.
Population density of agricultural land (1984):	366.0 per sq. km.
Population growth rate (1970-84):	3.1%
Urban population growth rate (1970-84):	4.6%
Crude birthrate (1984):	41 per thousand
Crude death rate (1984):	11 per thousand
Life expectancy at birth (1984):	50.6 years
Infant mortality (1984):	116.2 per thousand
Access to safe water (1981):	34.6% of population
Urban:	72.0
Rural:	20.0
Population per physician (1981):	3,190
Average size of household (1979):	6.7
Secondary school enrollment (1983):	15%
Adult literacy (1979):	24%
Labor force (1984):	26.4 million
Labor participation rate (1983):	28.3%
Percentage of income received by:	
highest 5% of households (1970):	17.8
highest 20% of households (1970):	41.8
lowest 20% of households (1970):	8
lowest 40% of households (1970):	20.2
Estimated absolute poverty income level^a (1979)	
Urban:	\$176.0 per capita
Rural:	\$122.0 per capita
Estimated relative poverty income level^b (1979)	
Urban:	\$88.0 per capita
Rural:	\$58.0 per capita
Estimated population below absolute poverty income level^c	
Urban:	32.0%
Rural:	29.0%

Source: Adapted from *Pakistan and the World Bank, Partners in Progress* (1986).

^aAbsolute poverty income level is the level below which a minimal nutritionally adequate diet plus essential nonfood requirements is not affordable.

^bRural relative poverty income level is one-third of average per capita personal income of the country. Urban level is derived from the rural level with adjustment for higher cost of living in urban areas.

^cPercentage of population (urban and rural) who are the "absolute poor."

Exhibit 4 Milk Production and Dairy Imports, 1975–1976 to 1985–1986

Year	Estimated Milk Production (000 tons)	Dairy Imports		
		Value (million Rs.)	Milk Equivalent (000 tons)	Imports/Production (percent)
1975–76	8,348	313.0	329.2	3.94
1976–77	8,524	251.0	165.8	1.94
1977–78	8,704	391.1	448.5	5.15
1978–79	8,888	321.6	237.0	2.67
1979–80	9,075	481.9	420.4	4.63
1980–81	9,267	552.3	352.8	3.81
1981–82	9,462	522.6	275.8	2.91
1982–83	9,662	736.8	357.4	3.70
1983–84	10,242	802.1	397.4	3.88
1984–85	10,856	712.0	315.6	2.91
1985–86	11,508	779.2	282.4	2.45

Source: Pakistan Economic Survey Data; imports data from Federal Bureau of Statistics. Adapted from **Table 4.2** in *Pakistan's Dairy Industry: Issues and Policy Alternatives*.

Exhibit 5 UHT Milk Production Costs

Cost Item	Rs./Liter
Raw milk ^a	2.66
Value of cream separated ^b	(0.45)
Net cost of raw milk	2.21
Conversion to 1 liter volume at 3.5% butter fat	<u>2.28</u>
Skimmed milk powder ^c	0.72
Processing cost ^d	1.72
Packaging cost	1.77
Transportation cost	0.08
Market returns/replacement ^e	<u>0.20</u>
Subtotal	6.77
Processor's margin	0.04
Distributor's margin	0.19
Retailer's margin	<u>0.50</u>
Subtotal	0.73
Retail price ^f	7.50

Source: International Consulting Division, Chemonics. Adapted from **Table 2.4** in *Pakistan's Dairy Industry: Issues and Policy Alternatives* (1989).

^aPrice of milk at 5% butterfat and 7% solid not fats.

^bCream (50% fat) valued at Rs. 15 per kilogram.

^cAdding 19 grams of skimmed milk powder @ Rs. 38/kg.

^dIncludes depreciation and financial charges.

^eMarket returns are assumed to be 3%.

^fRetail UHT milk price in Lahore zone. The price in other areas was Rs. 8/liter.

Exhibit 6 Print Advertisement for Milkpak Brand UHT Milk

تازہ خالص دودھ
 گھر بھر کیلئے بہترین

STAYS FRESH
 Milk Pak
 STANDARDISED MILK

ملک پیک ڈیری کی ایشیا بھاس عمدہ اور تازہ

Translation

Top Lines: Fresh, pure Milkpak milk—the best for the whole family.

Bottom Line: A product of Milkpak dairy. Pure, delicious, and fresh.

Exhibit 7 Print Advertisement for Milkpak Brand Butter

تازہ اور خالص دودھ سے تیار کردہ

Milk Pak مکھن

گھر بھر کیلئے بہترین

ڈیری کی اشیاء - خالص، عمدہ اور تازہ

میلک پک

Translation

Top Lines: Prepared from fresh and pure milk. Milkpak butter—the best for the whole family.

Bottom Line: A product of Milkpak dairy. Pure, delicious, and fresh.

Exhibit 8 Milkpak Sales Promotion and Advertising Expenses

1981	778,540 ^a	8.2% of sales
1982	1,517,576	1.6
1983	1,158,329	0.8
1984	900,204	0.4
1985	1,728,077	0.7
1986	8,283,452 ^b	2.4

Source: Company records.

^aSales promotion and advertising expenses of Rs. 778,540 were incurred in 1981, but were written off in three equal yearly instalments in 1982, 1983, and 1984.

^bIncrease in sales promotion expenses was required to launch new products and sustain market share.

Exhibit 9 Results of 1986 Milkpak Survey of Middle/High Income Urban Consumers on UHT Milk and Milk Powder

- 65% of respondents used more than one source of milk (e.g., UHT milk, fresh milk, powdered milk).
- In Karachi, 9% of respondents bought UHT milk; in Lahore, 25% bought UHT milk.
- 40% of respondents had no brand preference in purchasing UHT milk, while 35% preferred Milkpak.
- Respondents' prompted recall of the Milkpak brand name was 86%. Unprompted recall was 29%.
- 56% of UHT milk purchasers bought it in general stores, 25% in bakeries, and 16% in shops that were combined general stores/bakeries.
- 58% of respondents purchased UHT milk on a daily basis; 11% bought it three times a week; 18% purchased it twice a week; 13% purchased it less frequently.
- Respondents who did not purchase UHT milk cited the following reasons: it was too expensive (18%); they thought chemicals were added to the milk (12%); they were used to fresh milk (11%); UHT milk contained no cream (10%).
- Consumers purchased family milk powder for several reasons: to feed children (40%); to make the following foods: tea (16%), desserts (11%), yoghurt (11%), drinks made from milk (10%); and for drinking (11%).
- Respondents purchased milk powder from general stores (60%), combined general/medical stores (24%), and bakeries (10%).
- 74% of respondents purchased milk powder once a month; 23% bought it twice a month; only 3% purchased powdered milk weekly.

Source: Company records.

Exhibit 10 Milkpak Limited Milk Powder Plant Financial Feasibility Analysis

		Rs. '000		
1. Cost of Project and Sources of Finance				
1.1 Cost of Project				
Building			2,640	
Plant and machinery (including construction)			37,245	
Trial run cost and interest during construction			3,100	
Contingencies			<u>4,515</u>	
			47,500	
Working capital			<u>7,500</u>	
			55,000	
		Foreign Currency	Local Currency	Total
1.2 Sources of Finance				
Issue of preferential shares (one for every three shares)		—	11,667	11,667
Loan sanctioned by Agricultural Development Bank of Pakistan	16,000		2,000	18,000
New loan required	15,000		5,000	20,000
Bank overdraft	—		<u>5,333</u>	<u>5,333</u>
		<u>31,000</u>	<u>24,000</u>	<u>55,000</u>
		First Year	Second Year	Third Year
2. Profit and Loss Projections				
Sales 67,357	104,703		137,860	
Cost of sales	<u>57,928</u>		<u>86,798</u>	<u>111,407</u>
Operating profit	9,429		17,905	26,453
Financial cost/tax etc.	<u>6,259</u>		<u>6,024</u>	<u>12,140</u>
Net Profit	<u>3,170</u>		<u>11,881</u>	<u>14,313</u>
3. Payback period is three years and two months.				
4. Additional sales of UHT milk from increased availability of milk supplies as a result of project.				
	2,985		3,506	4,298

Source: Company records.